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Valuation of Real Estate with Easement

Oxana Šnajberg^{a*}^a*University of Economics, Prague; Department of Corporate Finance, W. Churchill Sq. 4, Prague 130 67, Czech Republic*

Abstract

This article deals with the easement valuation. The increased level of real estate with easement identification has prompted the reason of appraising such real estate. The article introduces the definition of and easement, all its properties and categories, because a proper understanding of all easement affections leads to better valuation. The basic principles of easement valuation focused on steps of easement valuation are also described in this article. At the end the Mr. Sherwood's easement valuation matrix is introduced and described with the definition of percentage of fee for different types of easement and different deepness of encumbrance.

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1. Introduction

The increased significance of easement identification of real estate and greater emphasis on its coherent valuation has prompted the reason of appraising such real estate. This article primarily focuses on identification of real estate easements and outlining possible approaches to valuation of such real estate.

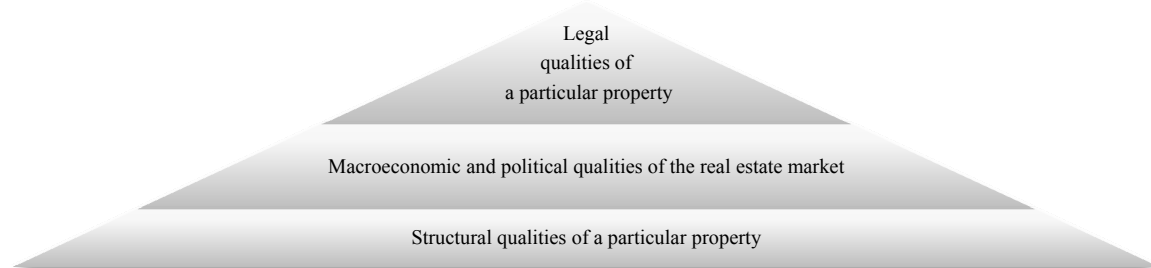
Due to a very specific and unique nature of each real estate easement we have to try to define it as thoroughly as possible. Therefore intention of this article is firstly to describe the meaning of the word “easement” and to characterize the different types of easement. Finally the article shall outline the possible methods of easement valuation, including their advantages and disadvantages.

* Corresponding author.

E-mail address: oxana.snajberg@gmail.com

2. Definition of Easement

The Easement is a conveyance of certain property rights, but not ownership, to a parcel of real estate¹. Sometimes easement is also defined as a portion of the ownership rights transferred to another individual or entity. Real estate is not just a physical object it is also comprised of rights and interests of the property. Ownership of real estate can contain a number of rights, including for example a right to use the real estate, to sell it, to lease it or to give it away. In case there is another party who has a certain right to your real estate, we call it easement. This should be taken into account in regards to valuation of the real estate. While valuating the appraiser should also value the right to use the real estate, to sell it, to lease it, to give it away etc. If the property is not encumbered by any easement it means that by purchasing such property the owner acquires all legal rights to such property. Basically the value of the real estate comprises of three main qualities: structural qualities, macroeconomic qualities of the real estate market and legal qualities. The value of an easement is a part of a legal quality of a real estate; however it can affect also the other qualities of the real estate. The real estate qualities are rendered in the diagram below.



Source: compiled by the author

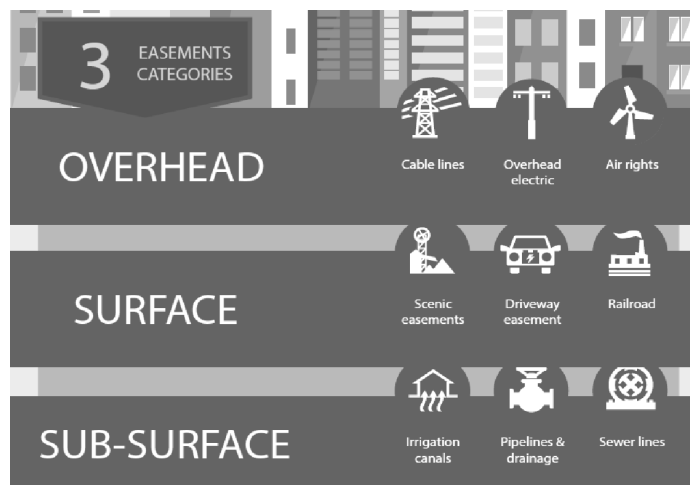
Fig. 1. Real estate features.

There are also many types of easement. With regards to duration of an easement, it can be permanent or temporary. Temporary easement usually terminates at the end of a construction or at the end of a specific use period.

With regards to space there are three types of easement: sub-surface, surface and overhead easement. Subsurface easement includes water constructions, gas pipelines, sewer lines, tunnels or other communication lines. The main sign of subsurface easement is that the project remains below and it is unseen. On the other hand the surface easement impacts the surface area. Examples of surface easement are railroad, highway, flowage, drainage etc. Typical overhead easement includes for example electrical transmission lines of aviation easement. There are also easements that may involve two or even all three of the aforementioned types of space². Multi-space occupancy is very common regarding easements qualities.

¹ Sherwood, D (2006): Easement valuation. International Right of Way Organization, May/June 2006. Available at: <https://www.irwaonline.org/eweb/upload/ROW%20Archives%2007-05%20thru%2007-06/506/Easement.pdf>

² e.g. overhead transmission lines require surface areas for the placement of the towers and some subsurface areas may be needed for the underground footings required.



Source: Sherwood, D. Easement valuation. Feature article, abstract of an article for a ROW Magazine, Now/Dec 2014 Edition

Fig. 2: Three easement categories.

Easement can be dominant or servient. When the easement is servient, the property is burdened by an easement. It is also called the negative easement. When the easement is dominant, then the property benefits from an easement. The easement gives an owner a right to perform a specific action on a property owned by another.

We can also divide easement into affirmative and negative. Affirmative easement is an easement that allows a specific use (e.g. right of way). Negative easement is an easement that prohibits a specific use (e.g. building height limitation).

No two easements are alike. Each easement is associated with a particular property. The key to the correct valuation of the easement which shall comprise all the attributes of the real estate is the widest possible identification of the valued easement.

3. Easement valuation

3.1. Basic principles of easement valuation

In order to perfectly value the real estate easement, the appraiser should realize that the easement represents the gain to the buyer as opposed to loss in value to the burdened property. While valuating the easement we basically look for the value of the impact of an easement on a particular real estate. An easement can decrease the value of a real estate, increase the value of the real estate or it can have no impact on the value of the real estate at all. The most important fact is that each property and situation should be evaluated on individual basis, taking into account all the circumstances.

The main task while valuating the easement is to recognize and specify the rights conveyed to the property. Afterwards it is very important to properly measure these rights. Rights can be both legal and physical.

The easement valuation has four steps. First of all the appraiser should identify the real estate, the easement of real estate and the appraisal problem. Then the appraiser should collect and analyze all available data. The appraiser should determine how the easement restricts the current use of the property and then collect the sales data on real estates that are most similar to the valued property, preferably real estates which are similarly encumbered with an easement. If there are no such similar real estates, then the appraiser should apply the other methodology principles to evaluate the easement. The pre final step is to apply the applicable approaches to the value by using the methods.

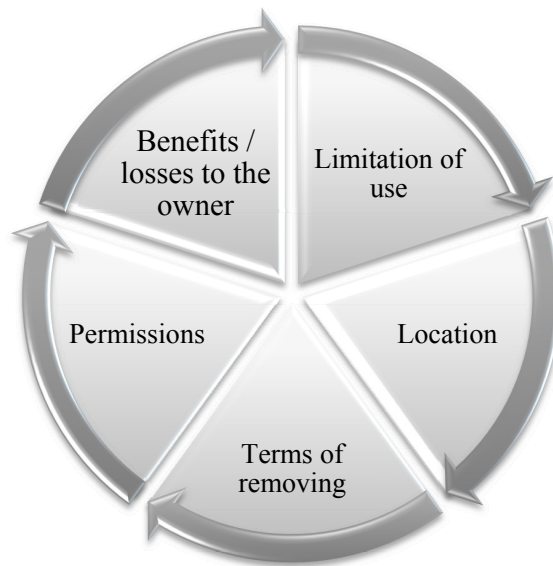
The best method for valuating real estate with easement if there is no other similarly encumbered real estate is to apply before and after method. In this method the appraiser calculate the value of real estate without influence of an easement and then measures the impact of the easement on the burdened property. While reconciling the final value of the real estate with easement the appraiser should remember that each easement is unique and each easement contains specific controls and restrictions that specify the easement affects to each property.



Source: compiled by the author

Fig. 3: Steps of easement valuation.

There are many questions that should be asked during identification of the easement of real estate. For correct valuation of the easement the appraiser should correctly identify all its rights. One of the most important things is to think about the use of the real estate and how the easement limits such use of the real estate. Then it is important to identify, where the easement is located. Location of an easement can be at the setback area of along the property. Different location causes different restrictions for the owner and it goes hand in hand with the usage of the property. Important is also whether easement can be removed and what are terms of its removing (financial or others). Important question while valuating an easement is if it has a permanent character or not. Will the landowner have to obtain permission to use the easement area? Can landowner cross the easement with roads, utilities, etc.? This all mentioned above is tightly bound with the benefits to the owner of the easement, its importance and size. The summary of main rights is rendered in the diagram below. All rights are strongly connected with each other and are sometimes even overlapping.



Source: compiled by the author

Fig. 4: Identification of main rights in context of real estate easement

It is important to recognize that the easement will impact the ownership title and may affect both current and future uses³. The main question while identifying the easement is whether the easement affects the highest and best use?

Very important are also the accessory rights, the ability to access the easement and ability to expand the use within the easement⁴. The appraiser should perfectly know how the easement is intended to be used and how it is constructed even if the easement is subsurface.

3.2. Methodology of easement valuation

In Basic principle in valuation of easement is to measure the difference between the value of the real estate without the easement and the value of the encumbered property. Usually there is a need of determine the just value of the easement in front of the court and market value is generally accepted as a just value or just compensation. While valuating the easement the appraiser should remember that every definition of the market value contains the willing seller and the willing buyer. While choosing the market valuation, the appraiser should consistently apply the market principles throughout the whole valuation. Talking about the market value we basically take into consideration the typical market participant and not the individual or entity that own the property. The market value of easement does not relate to the value to the user.

The most important appraisal principle while estimating the market value is the highest and best use. The real estate is usually appraised based on the theoretical highest and best use. Current or existing use of the real estate may not be necessarily being the best use.

It is known that while for one buyer the particular easement can have negative influence for other on the other hand the volume of negative influence may be smaller or even it can have even an opposite influence. Looking for the easement market value it should be found the amount of influence that the majority of respondents will feel. In valuation this is known as “the rule of independent party”. However the general guide of the effects that easements cause can be identified (in the schedule below).

It is very difficult to measure the volume of the easement due to imperfections on the real estate market and due to the fact, that easement represents only one of many factors affecting the buyer's decision. However there is no other basic method for valuation as a cost method, comparative method and yield method. Other methods are a combination or derivation of these three methods.

The appraiser can use the comparative method for easement valuation as matching the pairs analysis my matched the same property with the same easement. But as was said above this is practically almost impossible, and therefore this method is not often used even in this conception. Sales prices are not available and it is very hard to obtain such information, it is very difficult to compare the real easement transaction because every transaction (property) is different. Each easement is unique. Easements are not traded on the open market. That is why comparative method is almost impossible to use.

To analyze the value of easement due to its costs is also possible. But the problem is that the cost of “building up” an easement does not correspond with the easement market value. Cost of building up must not be the same as a loss in value to the burdened property. That is why it is not recommended to use the cost method in this case. Actually even European Valuation Standards do not consider this method for real estate valuation as a method for market valuation.

The most common methodology for easement valuation which is supported by appraisal literature and case law is the “before and after” methodology (rule). It means that the appraiser does not appraise an easement but rather

³ Sherwood, D (2006): Easement valuation. International Right of Way Organization, May/June 2006. Available at: <<https://www.irwaonline.org/eweb/upload/ROW%20Archives%207-05%20thru%207-06/506/Easement.pdf>>

⁴ e.g. add additional pipes.

measures the impact of the easement on the burdened property. The measure and impact or value of an easement is the loss in value to the remainder property after imposition of the easement⁵. Traditional before and after methodology is the best measure of the market impact of an easement on a particular property. When using other techniques usually leads to the estimation of some value other than market value. While looking for a market value of easement the appraiser's task is to determine the price for what will be the certain real estate sold encumbered with the similar easements.

3.3. Easement valuation matrix

The expert who deals with the real estate easement valuation during his whole life is Mr. Donald J. Sherwood. Mr. Sherwood is a managing director of a full service real estate appraisal and consulting company⁶. He has been an appraiser of all types of real property since December 1978. He has also spent many years as research assistant at Texas A&M University.

Sherwood's valuation matrix came ready from analyzing two similar sales of encumbered property and property without an easement. Then the impact of easement on the value was measured. After having a number of multiple pairings there was observed a general trend of the measured impact. The matrix was also the result of interviews with buyers and sellers.

Mr. Sherwood assembled the easement valuation matrix, which was developed under his observation between the difference of market sales of unencumbered and encumbered sales there was made a schedule of easement influence. Such analysis is very difficultly provided, because there are no two identical sales. However by gathering a sufficient number of matched pairs, a general trend which can give a market evidence of the effect of the easement on a value of real estate can be observed.

Table 1. Easement valuation matrix.

Potential Types of Easements	Comments	Percentage of Fee
Small subsurface easement	Nominal effect on use and utility	0 % to 10 %
Air rights		
Water sewer line	Subsurface or air rights that have minimal effect on use and utility Location with setback	11 % to 25 %
Water or sewer line		
Cable lines	Location along a property line, location across non usable land area	26 % to 49 %
Water or sewer lines		
Cable lines		
Telecommunications	Balanced use by both owner and easement holder	50 %
Pipelines		
Scenic easements	Some impact on surface use conveyance of ingress/egress rights	51 % - 74 %
Pipelines	Major impact on surface use	75 % to 89 %

⁵ Allen, A (2001): The Appraisal of Easements. International Right of Way Organization, November/December 2001. Available at: <<https://www.irwaonline.org/eweb/upload/1101c.pdf>>

⁶ Integra Realty Resources, www.irr.com

Drainage easements	Conveyance of future uses	
Flowage easements		
Overhead electric		
Flowage easements		
Railroad ROW	Severe impact on surface use	
Irrigation canals	Conveyance of future uses	70 % to 100 %
Access roads		

Source: Sherwood, D (2006): Easement valuation. International Right of Way Organization, May/June 2006. Available at: <https://www.irwaonline.org/eweb/upload/ROW%20Archives%207-05%20thru%207-06/506/Easement.pdf>

The schedule divides easement into several types such as subsurface easement, water sewer line, cable lines, railroad and access roads etc. To each type of easement Mr. Sherwood assigns a size of so called limitation. And under combination of the easement type and the total influence he signs a percentage of fees which is a result of his market observations.

According to Mr. Sherwood's schedule the smallest discount have small surface easement with the minimal effect on use. The discount of about 50 % is assigned to the easement such as cable lines, sewer lines or water lines with the balanced use by both owner and easement holder. The biggest influence according to Mr. Sherwood has drainage easement, railroad easements or access roads where the percentage of fee raises up to 75 to 100 %.

4. Conclusions

This article focuses on the easement valuation. The increased significance of real estate with easement identification has prompted the reason of appraising such real estate. The article introduces the definition of an easement, all its properties and categories. While looking for a market value of an easement appraiser should firstly study all the qualities, cons and pros. unfortunately every valuation of real estate with easement is very individual. That is why knowing all qualities are very important. The basic principle of valuation of real estate with easement focuses on steps. These valuation steps are described in this article. At the end the Mr. Sherwood's easement valuation matrix is introduced and described with the definition of percentage of fee for different types of easement and different deepness of encumbrance. But it is highly recommended to use these fees only as guidance and during every easement valuation have an individual conscientious approach.

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